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Supreme Court of the United States

OCTOBER TERM, 1926.

No. 318.

EMPIRE TRUST COMPANY,

Petitioner-Defendant,

against

CHARLES HAZLITT CAHAN,

Respondent-Plaintiff.

BRIEF ON BEHALF OF RESPONDENT-PLAINTIFF.

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CONTENTS.

PAGE

STATEMENT 2

ARGUMENT 4

FIRST: The deposit by a fiduciary in his individual bank account of checks which show on their face that they represent fiduciary funds is sufficient evidence of misappropriation to impose upon the bank a duty of inquiry 7

(a) The rule stated in the Point heading is sustained by many authorities in the Federal courts and in other jurisdictions and accords with well-established principles of notice adopted by this Court 7

(b) The rule is attended with a minimum of inconvenience 21

SECOND: The above rule applies *a fortiori* to agents who have no legal title to funds and upon whose authority the law imposes limitations, against use thereof for their own purposes, which all persons dealing with them are bound to notice 28

(a) Cahan, Jr., did not have actual authority either to draw checks for his own benefit or to dispose for his own benefit of the checks when drawn. He had no apparent authority to do these things as to any third person who was put on notice that he was acting for his own benefit 30

PAGE

(b) The weight of authority, with respect to agents, is that they are not entitled to deposit their principals' funds to individual credit, and that a bank which permits such a deposit is liable for a resulting misappropriation 36

(c) The New York decisions 41

THIRD: The facts of the present case require affirmance of the judgment whether or not the broad rule announced by the Court below is adopted 46

FOURTH: Certification or acceptance by drawee banks has no effect on defendant's duty of inquiry 51

FIFTH: The defendant was not a holder in due course under the Negotiable Instruments Law 52

SIXTH: The judgment should be affirmed 55

Table of Cases.

	PAGE
Allen *v.* Puritan Trust Co., 211 Mass. 409	50
43 A. L. R. 600, note	9
American Bonding Co. *v.* Fourth National Bank, 205 Ala. 652, 206 Ala. 639	26
Ames' Cases on Trusts, 484, note	9
Anderson *v.* Kissam, 35 Fed. 699 (C. C. S. D. N. Y.)	32
Angle *v.* North-Western Mutual Life Insurance Co., 92 U. S. 330	53
Bank of Hickory *v.* McPherson, 102 Miss. 852	8
Bank of New York *v.* American Dock and Trust Company, 143 N. Y. 559	30, 33
Baylies, New Trials and Appeals, 3 ed., 71-72	2
Beuttell *v.* Magone, 157 U. S. 154	2
Bischoff *v.* Yorkville Bank, 218 N. Y. 106	24, 29, 44, 50
Brovan *v.* Kyle, 166 Wis. 347	26
Charleston Paint Co. *v.* Exchange Banking & Trust Co., 129 S. C. 290	37
Cheever *v.* Pittsburgh, etc. Co., 150 N. Y. 59	53
Colonial Bank *v.* Cady and Williams, L. R. 15 A. C. 267	22
Commercial Savings Bank & Trust Co. *v.* National Surety Co., 294 Fed. 261 (C. C. A. 6th Circ.)	13
Corporation Agencies, Ltd. *v.* Home Bank of Canada, Appendix to Defendant's Brief herein	38
2 Corpus Juris, 642-643	35
Duckett *v.* Mechanics' Bank, 86 Md. 400	8
Duckett *v.* Bank of Baltimore, 88 Md. 8	8
Duncan *v.* Jaudon, 15 Wall. 165	13, 14

PAGE

Empire State Cattle Co. *v.* Atchison Railway Co., 210 U. S. 1 2

Ex Parte Darlington District Joint-Stock Banking Co., 4 De G., J. & S., *581 8

Farmers Loan & Trust Co. *v.* Fidelity Trust Co., 86 Fed. 541 (C. C. A. 9th Circ.) 7, 9

Fidelity & Deposit Co. *v.* Queens County Trust Co., 226 N. Y. 225 ..... 44, 54

First National Bank of New Jersey *v.* Leach, 52 N. Y. 350 51

First National Bank of Washington *v.* Whitman, 94 U. S. 343 51

Gate City Building & Loan Association *v.* National City Bank, 126 Mo. 82 38

Gerard *v.* McCormick, 130 N. Y. 261 43

Gilman *v.* F. O. Bailey Carriage Co., 125 Me., 108 53

Goodwin *v.* American National Bank, 48 Conn. 550 36

Gray *v.* Johnston, L. R., 3 H. L. 1 ..... 14, 15

Hale *v.* Windsor Savings Bank, 90 Vt. 487 26

Havana Central Railroad Co. *v.* Central Trust Co., 204 Fed. 546 (C. C. A. 2nd Circ.) 7, 9

Havana Central Railroad Co. *v.* Knickerbocker Trust Co., 198 N. Y. 422 ..... 11, 41, 43

Havana Central R. R. Co. *v.* Knickerbocker Trust Co., 135 App. Div. 316 17

Hoberg *v.* Sofranasy, 217 App. Div. 546 54

Lowry *v.* Commercial & Farmers' Bank of Maryland, Taney's Circuit Court Decisions, 310 14

McCullam *v.* Third National Bank, 209 Mo. App. 266 37

PAGE

Manhattan Bank *v.* Walker, 130 U. S. 267 15
Mitchell *v.* First National Bank of Hopkinsville, 203 Ky. 770 8
Moch Co. *v.* Security Bank, 176 App. Div. 842 (affirmed without opinion, 225 N. Y. 723) 41

National Bank *v.* Insurance Co., 104 U. S. 54 ..... 13, 27
National Safe Deposit Co. *v.* Hibbs, 229 U. S. 391 35
New York Negotiable Instruments Law, Secs. 91, 94, 95, 96, 98 52-55
Niagara Woolen Co. *v.* Pacific Bank, 141 App. Div. 265 ..... 8, 19, 45
North River Bank *v.* Aymar, 3 Hill, 262 32

Oklahoma State Bank *v.* Galion Iron Works, 4 F. (2d) 337 ..... 7, 12

Park Hotel Co. *v.* Fourth Nat. Bank of St. Louis, 86 Fed. 742 31
1 Perry on Trusts, 4 ed. Sec. 443 9
Porges *v.* U. S. Mortgage & Trust Co., 203 N. Y. 181 ..... 7, 34, 41, 43

Rochester & Charlotte Turnpike Road Co. *v.* Paviour, 164 N. Y. 281 ..... 43, 53, 54
Ross *v.* London Co. Westminster & Parr's Bank, Ltd., [1919] 1 K. B. 678 8

Safe Deposit & Trust Co. *v.* Bank, 194 Pa. St. 334 36
Santa Marina Co. *v.* Canadian Bank, 254 Fed. 391 (C. C. A. 9th Circ.) 13, 39, 50
Professor Austin W. Scott in 34 Harvard Law Review, 454 ..... 8, 14
Sena *v.* American Turquoise Co., 220 U. S. 497 2
Sims *v.* U. S. Trust Co., 103 N. Y. 472 ..... 8, 41
Spaulding *v.* Kelly, 43 Hun, 301 ..... 8, 43

	PAGE
Stainer v. Tysen, 3 Hill, 279	32
Story on Agency, Section 208	39
Taylor v. Harris' Admr., 164 Ky. 654	8
Toronto Club v. Imperial Trusts Co., 25 Ont. L. Rep. 330	8
A. L. Underwood, Ltd., v. Bank of Liverpool, [1924] 1 K. B. 775	8, 22, 41
Union Nat. Bank v. Bluff City Bank, 152 Tenn. 486	54
Union Stock Yards Bank v. Gillespie, 137 U. S. 411	13
Union Trust Company, Matter of, 219 N. Y. 514	9
U. S. Fidelity & Guaranty Co. v. Adoue, 104 Tex. 379	8
U. S. Fidelity & Guarantee Co. v. People's Bank, 127 Tenn. 720	8
United States v. National Exchange Bank, 270 U. S. 527	21
Wagner Trading Co. v. Battery Park National Bank, 228 N. Y. 37	7, 40, 44
Ward v. City Trust Co., 192 N. Y. 61	16, 43, 53, 54
Warren-Scharf Asphalt Paving Co. v. Commercial National Bank, 97 Fed. 181	12
Whiting v. Hudson Trust Co., 234 N. Y. 394	29, 44, 51
Zane, Banks and Banking, p. 217	29

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No. 318.

BRIEF ON BEHALF OF RESPONDENT-PLAINTIFF.

This writ of *certiorari* brings up for review a decision of the Circuit Court of Appeals for the Second Circuit (Judges Hough, Learned Hand and Mack sitting), which affirmed a judgment of the District Court for the Southern District of New York (Judge Winslow presiding) in favor of the plaintiff.

At the opening of trial the parties stipulated that the case should be tried by a jury of one and that at the conclusion of the evidence each party should move for a directed verdict (Record, fol. 86). Cross motions for directed verdicts were accordingly made by both parties (fols. 458-9) and the judgment was entered upon the granting by the Trial Judge of plaintiff's motion (fols. 464, 77-80).

The effect of the above procedure was to confer upon the Trial Judge the duty to resolve all questions of fact and to draw all legitimate inferences from facts, and his

decision on all disputed questions of fact is conclusive if there was any evidence to sustain it (*Beuttell* v. *Magone*, 157 U. S. 154, 157-8; *Empire State Cattle Co.* v. *Atchison Railway Co.*, 210 U. S. 1, 8-9; *Sena* v. *American Turquoise Co.*, 220 U. S. 497; *Baylies, New Trials and Appeals*, 3 ed., 71-72).

Statement.

It is unnecessary for us to present a complete statement of the case, since much of the ground is covered in the Statement of Facts in defendant's brief.

It must be taken as established that all of the twenty-one checks involved in this action were frauds on the part of Cahan, Jr., against the plaintiff, his father. Plaintiff's testimony is explicit that he never authorized or had any knowledge of any of them; that he never had any transactions with either Cahan, Jr., or defendant, by virtue of which any such amounts were properly payable to either of them; that he had no relations with defendant, as depositor or otherwise, and did not know of Cahan, Jr.'s account with it; and that no one of these checks was drawn for any purpose of plaintiff's (fols. 132, 136-138, 142-146, 226-230). As this testimony was uncontradicted, corroboration of it was unnecessary, but corroboration of the fraud appeared from the manner in which Cahan, Jr., covered up the transactions in the plaintiff's check books with the Agents of the Bank of Montreal and the Guaranty Trust Company, either by making no entry at all of the fraudulent check on any stub, or by entering on the stub a notation of a check of the same number as that of the fraudulent check but to a different payee and for a different amount (fols. 147-178, 187-

225; Pl.'s Exhs. 6 to 6-J, fols. 547-555). Thus the frauds remained undiscovered until after Cahan, Jr.'s precipitate disappearance on the night of December 26, 1919 (fols. 120-135).

While, as defendant says in its brief (p. 5), plaintiff did not definitely know exactly what Cahan, Jr., did with the funds after their deposit with defendant, he did know and testified explicitly that they were not used for any purpose of plaintiff, and the inference is clear that Cahan, Jr., misappropriated them to his own use (fols. 262-264, 271-275).

On this subject the District Judge found as follows:

> "The proceeds of the checks thus deposited with the defendant were used by Cahan, Jr., for his personal use and benefit, and not for the benefit or account of the plaintiff" (fol. 724).
>
> • • • • • •
>
> "The agent did not in fact have actual authority either to draw these particular checks or to deposit them to his personal credit with defendant" (fols. 725-6).

The District Judge also found that three of the checks were drawn by Cahan, Jr., to pay indebtedness of his to the defendant:

> "Whether the checks were drawn to pay the agent's indebtedness to the defendant (which would seem to be the case in three instances referred to) • • •" (fol. 727).

This finding was in response to plaintiff's contention that the deposit by Cahan, Jr., of three of the checks in question covered overdrafts in his account. We shall discuss

under Point Third the evidence upon this question, as well as other circumstances which in our view conveyed to defendant unusually direct notice of Cahan, Jr.'s, purposes.

It is conceded that defendant never inquired of plaintiff, or of anyone else, as to Cahan, Jr.'s, authority to draw these checks or to dispose of the same for his own benefit. There is no evidence that defendant had any knowledge of the powers of attorney. The circumstances under which these were given are described in the record (fols. 104-118).

Defendant's answer admits "that defendant collected each of said twenty one (21) checks from said Agents of the Bank of Montreal or from the Guaranty Trust Company of New York" (Par. Sixth, fol. 51); and "that after collection, the proceeds of each of said twenty-one (21) checks were placed to the credit of the personal account of said C. H. Cahan, Jr., with the defendant and said proceeds were thereafter withdrawn by said C. H. Cahan, Jr." (Par. Fifth, fol. 50). The defendant's answer also admits (Par. Third, fol. 48) the form of the checks, as alleged in Paragraph XI of the complaint (fols. 25-35). This includes the fact that the twenty-first check (referred to on page 4 of defendant's brief), dated October 15, 1918, for $2,400, was payable to the order either of C. H. Cahan, Jr., or the defendant (fol. 35).

Argument.

These twenty-one checks all bore on their face the badge of a fiduciary relation. They were all signed "C. H. Cahan, by C. H. Cahan, Jr., His Attorney." Seventeen of them were made payable to the order of C. H. Cahan, Jr., him-

self. Three were made payable to the defendant bank, with which the plaintiff had no relations, but in which Cahan, Jr., maintained his individual checking account. The twenty-first check was made payable in one of the above two ways.

It is unquestioned law that one who deals with fiduciary funds, with notice of their character, in such a way as to facilitate a misappropriation thereof by the fiduciary, is liable for such misappropriation. One who takes from a fiduciary a check signed by him in a fiduciary capacity is liable if he has knowledge or notice that the fiduciary's purpose is to use the funds for his individual benefit. The most familiar example is the taking of such a check in payment of the fiduciary's individual indebtedness to the recipient. The decisions are substantially unanimous in imposing liability in these circumstances, and so much is conceded by the defendant.

The Court below held that the same principles impose liability upon a bank which permits an agent to deposit checks signed by him as agent in his individual bank account. The view of the Court below is that the form of the checks and the agent's direction to deposit them to his individual account are sufficient notice of probable misfeasance to put the bank upon inquiry. The contrary view, advanced by defendant, is that, in spite of appearances, the bank is entitled to presume that the agent's intentions and his use of the funds are innocent.

But there are only two assumptions upon which propriety in such circumstances might be predicated, (1) that the agent is entitled to the money in his own right, or, (2) if not, that he will use the funds, though in his individual account, for his principal's purposes. Plainly the first as-

sumption may not be indulged, because it would apply as well to the case in which the agent uses the funds to pay his individual indebtedness, and it is universal law that such a transaction may not be presumed to be innocent. But the second assumption involves even more serious conflict with probabilities. The principal has his own bank account on which checks for his purposes may be drawn. As Judge Hough said in the Court below, the only case in which the principal's interests would be served by a withdrawal of funds from his own account to the individual account of the agent would be one in which it was important to "conceal his principal's name in a transaction in which even a cashier's cheque might excite suspicion" (R. p. 281).

The Court below then based its decision upon an affirmative answer to the broad question which it phrased thus (R. pp. 269-270):

> "Is an agent's bank of deposit put on notice by, and does it take at its peril if it receives without investigation, a cheque drawn by the agent on his principal's funds to his own order and tendered for the credit of his private account?"

We submit that the facts and circumstances disclosed by this record, which we shall discuss in Point Third, require the affirmance of this judgment, whether or not that broad principle be accepted. We propose first, however, to discuss the general question. We believe that the rule announced by the Court below is correct, and that its adoption by this Court would end much uncertainty in a branch of the law in which certainty is peculiarly desirable, and would promote the establishment by banking institutions throughout the country of a wholesome and convenient practice in their dealings with fiduciary funds.

FIRST: The deposit by a fiduciary in his individual bank account of checks which show on their face that they represent fiduciary funds is sufficient evidence of misappropriation to impose upon the bank a duty of inquiry.

In the discussion under this Point we shall disregard the particular character of the fiduciary whose acts are involved. We shall for the moment assume the correctness of defendant's contention (Brief, p. 14) that there is no distinction, so far as the liability of banks in which their funds are deposited is concerned, between trustees, executors, guardians and other fiduciaries who have legal title to funds, on the one hand, and agents and corporate officers who have no such title, on the other, and shall postpone discussion of this distinction and of defendant's authorities until Point Second, *infra*. Certainly decisions imposing liability in cases in which the fiduciary has the legal title are *a fortiori* authority in this case.

(a) The rule stated in the Point heading is sustained by many authorities in the Federal courts and in other jurisdictions and accords with well-established principles of notice adopted by this Court.

The following authorities sustain the rule stated in the point heading.

Farmers Loan & Trust Co. v. *Fidelity Trust Co.*, 86 Fed. 541 (C. C. A. 9th Circ.); *Havana Central Railroad Co.* v. *Central Trust Co.*, 204 Fed. 546 (C. C. A. 2nd Circ.); *Oklahoma State Bank* v. *Galion Iron Works*, 4 F. (2d), 337 (C. C. A. 8th Circ.)

Wagner Trading Co. v. *Battery Park National Bank*, 228 N. Y. 37; *Porges* v. *U. S. Mortgage & Trust Co.*, 203

N. Y. 181; *Sims* v. *U. S. Trust Co.*, 103 N. Y. 472; *Niagara Woolen Co.* v. *Pacific Bank*, 141 App. Div. 265; *Spaulding* v. *Kelly*, 43 Hun 301.

Taylor v. *Harris' Admr.*, 164 Ky. 654, 669-673; *Mitchell* v. *First National Bank of Hopkinsville*, 203 Ky. 770.

Duckett v. *Mechanics' Bank*, 86 Md. 400; *Duckett* v. *Bank of Baltimore*, 88 Md. 8.

U. S. Fidelity & Guarantee Co. v. *People's Bank*, 127 Tenn. 720.

Bank of Hickory v. *McPherson*, 102 Miss. 852.

U. S. Fidelity & Guaranty Co. v. *Adoue*, 104 Tex. 379, 392, 395.

A. L. Underwood, Ltd. v. *Bank of Liverpool*, [1924] 1 K. B. 775; *Ex Parte Darlington District Joint-Stock Banking Co.*, 4 De G., J. & S., *581, *585-6; *Ross* v. *London Co. Westminster & Parr's Bank, Ltd.*, [1919] 1 K. B. 678, 686.

Toronto Club v. *Imperial Trusts Co.*, 25 Ont. L. Rep. 330, 343.

On pages 8 and 9 of its brief defendant cites a large number of cases which, it argues, support the proposition that "it is almost universally held that a fiduciary, of whatsoever kind, may deposit the funds of his principal in a bank to his individual credit."

If this is intended to mean that the fiduciary has a right so to do, it cannot be accepted as the law, and very few of the cases cited support it. Professor Austin W. Scott in his article in 34 *Harvard Law Review*, 454 (upon which defendant relies), recognizes (p. 467) that "as a rule, the trust funds should be deposited in an account separate from that in which the trustee keeps his own funds, and the form of the deposit should be such as to indicate its fiduciary char-

acter; and according to the weight of authority if the bank becomes insolvent the trustee is personally liable if the trust fund was blended with the trustee's individual account; and even if there was no such blending he is liable if the deposit does not on its face indicate its fiduciary character." For collections of cases on this rule, which applies to all fiduciaries whether having the legal title or not, see 43 *A. L. R.* 600, Note; 1 *Perry on Trusts*, 4 ed. Sec. 443; *Ames', Cases on Trusts*, 484, Note. Such a form of deposit, at best, may seriously complicate the administration of the trust. In case of attachment by creditors of the fiduciary individually, or in case of the fiduciary's death, it will often require litigation to establish the rights of the beneficial owner. See *Matter of Union Trust Company*, 219 N. Y. 514, 521-522.

Defendant's contention must, therefore, rest not on any right of the fiduciary to make such an individual deposit, but on the proposition that, although the fiduciary has committed a breach of trust, the bank is not liable for permitting him to do so. Upon this question a comparison of the authorities cited by the defendant, with those above cited by us, shows that there is a wide conflict of authority throughout the country. Sometimes, as in New York, the decisions in the same jurisdiction appear inharmonious.

The cases in the national courts, however, have been fairly uniform. The Circuit Court of Appeals for the Ninth Circuit applied the rule to facts which, in spite of defendant's attempt, we submit are indistinguishable from the present, in *Farmers' Loan & Trust Co. v. Fidelity Trust Co.*, 86 Fed. 541. There the general agent of a corporation drew a draft upon its treasurer and transferred it to his bank for a certificate of deposit in his name as an individual.

The Court, holding that the defendant bank was liable for the resulting misappropriation, said (pp. 554-545):

> "When an agent draws a draft in the name of his principal, and receives from a bank the money therefor, the presumption, in the absence of any showing to the contrary, is that he receives the money in the same capacity in which he draws the draft; that is to say, as agent. But when the agent, for such a draft, asks for and receives from the bank a certificate of deposit in his individual name, not only is such bank thereby put upon inquiry as to why, for money of the principal, the agent wants such certificate in his individual name, but such conduct—nothing to the contrary appearing—is equivalent to a declaration by the agent that the money is received by him in his individual capacity, and for his individual use; for certainly the legal presumption that follows the deposit of money in the individual name of a man is that the money so deposited is the property of the depositor."

In *Havana Central Railroad Co. v. Central Trust Co.*, 204 Fed. 546, 551 (C. C. A. 2d Circ.) Judge Noyes said:

> "But if the bank have knowledge that the officer is using the check for his personal benefit, *e. g.* to pay his debt to the bank or to deposit it to his personal credit, then the bank is put upon inquiry and if it fail to make it, pays at its peril."

In that case the plaintiff corporation had a deposit account with the defendant, the Central Trust Company. Its Treasurer signed checks in the plaintiff's name, by himself as treasurer, payable to his own order, and deposited them in his individual account with the Knickerbocker Trust Com-

pany. The plaintiff's action against that bank, which corresponded on its facts to the present action, was in the New York State courts and, after the plaintiff had been successful in the Special Term and Appellate Division, finally resulted in a judgment for defendant (*Havana Central Railroad Co.* v. *Knickerbocker Trust Co.*, 198 N. Y. 422). This decision of the Court of Appeals was upon the ground that, while the form of the checks was sufficient to put the depositary bank upon inquiry, that duty of inquiry was satisfied by the mere fact that the checks were paid by the Central Trust Company, upon which they had been drawn, which bank the Court said was the "agent" of the plaintiff to make representations to third persons as to the validity of checks drawn upon the plaintiff's account. The case in the Federal Court was against the Central Trust Company, upon which the checks had been drawn, which we shall refer to as the "drawee bank". The Circuit Court of Appeals took direct issue with the State Court upon the fundamental proposition that the primary responsibility was upon the drawee bank. Judge Noyes said (pp. 548-549, 550):

> "It is impossible to give the decision of the Court of Appeals a narrow interpretation. It was based upon the assumption that the Knickerbocker Company was put upon inquiry because the checks were drawn by the treasurer to his own order and were deposited to his personal credit. The inquiry involved two questions:
>
> "(1) The authority of the treasurer to draw checks of that kind.
>
> "(2) His authority to draw these checks and use them for his own purposes.

> "An answer to the first question would not have relieved the holder put upon inquiry. • • •
>
> "The defendant did not know the history of the checks. It did not have the knowledge of the Knickerbocker Company that the treasurer was using the checks for his personal benefit."

The Circuit Court of Appeals therefore held that under the facts of that particular case the *drawee bank* was not liable for honoring the checks. The same distinction is implicit in the decision of the Circuit Court of Appeals for the Sixth Circuit, in *Warren-Scharf Asphalt Paving Co.* v. *Commercial National Bank*, 97 Fed. 181, which was also an action against the drawee bank, and involved a check drawn by a corporate officer upon its bank account to the order of "Cash".

Quite recently the rule which was applied in the instant case was enunciated by the Circuit Court of Appeals for the Eighth Circuit in *Oklahoma State Bank* v. *Golion Iron Works*, 4 F. (2d) 337, as follows (pp. 338-339):

> "That an agent may not deposit funds collected by him for his principal with a bank to his own individual credit, and draw them for his own personal and private use, in the absence of authority from his principal is well settled, and when a bank with knowledge that its funds belong to the principal and not the agent, which was apparent from the face of the warrants, permits him to do so, it is liable to the principal for the moneys thus deposited and withdrawn by the agent on his individual check and by him converted to his own use, and embezzled, unless the agent acted within the apparent scope of his authority, which is not claimed, or the principal, with knowledge of the acts of the agent permits him to do so, or ratifies his acts."

The only decisions of the federal courts upon which defendant relies are *Santa Marina Co.* v. *Canadian Bank*, 254 Fed. 391 (C. C. A. 9th Circ.), and *Commercial Savings Bank & Trust Co.* v. *National Surety Co.*, 294 Fed. 261 (C. C. A. 6th Circ.). The latter case is plainly not in point. There one F. received a check payable to the order of "F., Trustee". He did, it is true, temporarily deposit it in his personal account with the defendant, but a few days later he withdrew from his personal account a larger sum by a check to the order of "F., Trustee". The court said (p. 264):

> "• • • even if the bank were to be charged with knowledge that it received this money from a trustee, it later returned the money to the same trustee, and certainly cannot now be held for the subsequent embezzlement of the funds, to the possession of which, in so far as this bank was concerned, the trustee was clearly entitled."

The *Santa Marina* case is the only decision in the federal courts, of which we know, which supports defendant's contentions. We believe it to be incorrectly decided and to be out of line with the principles enunciated by this Court in its decisions that a bank is liable if it takes fiduciary funds in satisfaction of the fiduciary's individual indebtedness to it. *Duncan* v. *Jaudon*, 15 Wall. 165; *National Bank* v. *Insurance Co.*, 104 U. S. 54; *Union Stock Yards Bank* v. *Gillespie*, 137 U. S. 411.

The rule that where negotiable paper, bearing on its face the badge of a fiduciary character, is tendered in payment of the private debt of a fiduciary, the transaction is "*prima facie* wrongful" and the taker is bound to make inquiry as to the propriety of the fiduciary's conduct, is

practically universal. See article by Professor Scott, 34 *Harvard Law Review*, 454, 460-462, 474-475. According to some cases, of which *Gray* v. *Johnston*, L. R., 3 H. L. 1, cited by defendant, is the leading example, the reason is that benefit to the creditor is "designed or stipulated for." But according to the majority view, the feature of benefit to the recipient of the funds is immaterial, and the reason for the rule is that the use of the funds by the fiduciary to satisfy his individual indebtedness is clear evidence of use of the fiduciary funds for individual purposes. So Professor Scott says, "The result is the same whenever the circumstances are such as to make it evident that the transaction is for the personal benefit of the fiduciary."

The decisions of this Court have uniformly been based upon the second view above expressed. In the leading case of *Duncan* v. *Jaudon*, 15 Wall. 165, in which a trustee pledged as security for his personal indebtedness to two banks stock which stood in his name as trustee, this Court held that the banks were liable upon the ground that the nature of the transaction gave them "actual or constructive notice that the trustee was abusing his trust and applying the proceeds of the loans to his own use". This holding was based upon a decision of Mr. Chief Justice Taney, sitting in Circuit (*Lowry* v. *Commercial & Farmers' Bank of Maryland*, Taney's Circuit Court Decisions, 310), which laid down the rule that "if a party dealing with an executor has, at the time, reasonable ground for believing that he intends to misapply the money, or is, in the very transaction, applying it to his own private use, the party so dealing is responsible to the persons injured."

The fact that the test is notice of misappropriation rather than benefit received by the bank is made clear by

the decision of this Court in *Manhattan Bank* v. *Walker*, 130 U. S. 267. In that case the plaintiff through one J, her agent, placed a certain note of a third party and certain railroad bonds with the defendant bank on a special deposit, the bank giving J a receipt running to him as "agent" for the plaintiff. The bank never came in contact with the plaintiff, but had large dealings with J through various accounts which he kept as "agent" or "guardian". J's firm became indebted to the defendant bank and in this situation J discounted with it the above mentioned note and lent the proceeds to the firm by depositing it in its account with the defendant. J then persuaded the defendant to deliver the bonds to him for the purpose of negotiating a loan from another bank where he also had an account. Plaintiff sued the defendant bank for the value of both the note and the bonds. In the lower court (25 Fed. 247) Judge Hammond held the defendant bank liable for the value of the note, but absolved it from liability on the transaction with respect to the bonds on the ground that "participation in the profits of the fraud" is generally speaking a requisite to liability and that "mere reason to believe that the trustees were misapplying the assets" was not sufficient, citing (p. 255) *Gray* v. *Johnston*, L. R., 3 H. L. 1, *supra*. On appeal this Court held the defendant bank liable for both transactions saying with respect to the bonds (p. 279):

> "Knowing, from what passed between Maas and Judah, that the bonds were to be used to raise money for the benefit of Walker Sons & Co., and knowing that such use was an improper disposition of the bonds, unless the transaction were affirmatively and directly sanctioned by the plaintiff, the defendant became a party to the misappropriation of the bonds.

> It is immaterial, in this view, whether or not the defendant received any portion of the money loaned by the Bank of Commerce on the security of the bonds."

The decisions of American courts generally base the rule of liability in a case of the taking of fiduciary funds in satisfaction of or as security for an individual indebtedness of the fiduciary upon the ground of notice rather than that of benefit to the recipient of the funds. The leading case in New York, *Ward* v. *City Trust Co.*, 192 N. Y. 61, is typical. There the Court of Appeals said (pp. 69, 72-73):

> "The form of the check in question was notice to the trust company that Umsted was using the property of the corporation of which he was president, to pay the personal debt of himself and Kiefer in apparent violation of its rights. (*Rochester & Charlotte Turnpike Road Company* v. *Paviour*, 164 N. Y. 281; *Gerard* v. *McCormick*, 130 N. Y. 261; *Hathaway* v. *County of Delaware*, 185 N. Y. 368, 372.) • • •
>
> "If the check had been regular on its face, that is, if it appeared to have passed through the hands of the Hartman Company, and thence into the channels of commerce, as in a case relied upon by the respondent, then, even if offered in payment of his personal debt by one of the officers of the company, the taker without notice would have the right to assume that the relations of the various parties to the paper were what they appeared to be. (*Cheever* v. *Pittsburgh, Shenango & Lake Erie R. R. Co.*, 150 N. Y. 59, 66.) The case before us, however, is utterly different, for the check showed on its face that it did not belong to Umsted or Kiefer, but to the Hartman Company. As was said in the *Paviour Case* (*supra*): 'There was a shadow on the checks, and

the defendant could not, in good faith, accept them until it disappeared. By accepting them he did an act which he had reason to believe would affect the rights of a third party, and he could not, in justice to that party, ignore the suspicions which the facts should have aroused. One who suspects, or ought to suspect, is bound to inquire, and the law presumes that he knows whatever proper inquiry would disclose. While the courts are careful to guard the interests of commerce by protecting the negotiation of commercial paper, they are also careful to guard against fraud by defeating titles taken in bad faith, or with knowledge, actual or imputed, which amounts to bad faith, when regarded from a commercial standpoint.' "

The question then is whether the deposit by a fiduciary in his current individual bank account of fiduciary funds, known to be such, gives the depositary bank, in Chief Justice Taney's language "reasonable ground for believing that he intends to misapply the money",—whether, in the language of the New York case above quoted, the bank in accepting them "did an act which it had reason to believe would affect the rights of a third party" and which accordingly it could not in justice to that party do until the "shadow on the checks" had been removed by proper inquiry.

On principle it is difficult to imagine clearer notice of probable misappropriation. Judge Ingraham said when the *Havana Central R. R. Co.* case was in the Appellate Division (*Havana Central R. R. Co.* v. *Knickerbocker Trust Co.*, 135 App. Div., p. 316):

"On its face this is clearly a transaction by which Van Voorhis was abstracting money from the treas-

ury of the company to be credited to his individual account with the defendant. Certainly any bank officer looking at this check would see that Van Voorhis had drawn or was attempting to draw from the plaintiff's deposit account the sum of money there named to be paid to his own order. * * * A person having an individual claim against Van Voorhis and receiving in payment such a check to pay Van Voorhis' individual debt would clearly have notice that Van Voorhis was using the funds of the plaintiff to pay an individual debt for which the plaintiff was not responsible. In this case Van Voorhis went to the bank, presented three checks drawn by the plaintiff, acting through himself as treasurer, payable to his own order, and indorsing them deposited them with the defendant, which defendant accepted and received the proceeds. By that transaction the defendant became the owner of the check and its proceeds and became personally indebted to Van Voorhis individually for the amount of the checks. The effect of this transaction, of which the defendant must be chargeable with notice, was that the plaintiff's money had been taken from its possession and control and transferred to the defendant corporation, who in return for the payment of that money to it had become indebted to Van Voorhis individually for the amount that it received. This, it seems to me placed the defendant in the same condition as if Van Voorhis had actually used the check or its proceeds to pay all individual indebtedness to the defendant with notice to the defendant of the actual ownership of the money or check used for that purpose."

The same Justice said in *Niagara Woolen Company* v. *Pacific Bank*, 141 App. Div. 265, 268-269:

> "In *Havana Central R. R. Co.* v. *Knickerbocker Trust Co.* (*supra*) I stated the reasons which satisfied me that there could be no distinction between a case where the bank received the money in payment of a debt to itself and a case where it received the money and paid it out upon the private direction of the agent or trustee for his own individual purposes, and it is unnecessary that I should restate them here. But applying the principle which the Court of Appeals has now definitely stated to be the law of this State, as illustrated in *Ward* v. *City Trust Co.* (*supra*), namely, that the question is merely one of notice to the bank, it seems to me that it can make no difference whether the bank knew that Horowitz was applying the proceeds of the checks belonging to plaintiff to his own debt to the bank or to satisfy his private obligations to others; that in either case, where inquiry would have at once disclosed the limitations of Horowitz's authority and that he was misappropriating the property of the plaintiff, the bank cannot deliberately shut its eyes to facts which upon their face show a misapplication and thus aid a defaulting officer or trustee in securing the proceeds of his defalcation. The reversal by the Court of Appeals of *Havana Central R. R. Co.* v. *Knickerbocker Trust Co.* (198 N. Y. 422) recognizes this rule."

Defendant argues (Brief, p. 9) that "the bank has the right to assume that a fiduciary will apply the funds to their proper use under the trust". Defendant's theory is that it was entitled to assume that the transfer of the funds by Cahan, Jr., from the plaintiff's account to his individual

account was done for the plaintiff's benefit and in his interests; and that it was entitled to assume that Cahan, Jr., would use the fiduciary funds, though mingled with his personal funds, only for his principal's purposes

We submit that such an assumption flies in the face of manifest probabilities. The very difficulty of imagining any reason why the principal's interests would be promoted by transfer of his funds to his agent's individual bank account is sufficient evidence of the violence of the assumption. The principal has his own account. The agent has power to draw checks upon it to satisfy any of his principal's obligations. If, for some legitimate reason, it is important to keep the principal's name out of the transaction, a cashier's draft may be used. And in view of the improbability that the principal has authorized or desired the transfer of his funds to the agent's individual account, what basis is there for the assumption that the agent will use them only for his principal's benefit? Experience teaches that a transfer by a fiduciary to his individual account of funds to which he is not individually entitled is usually the first step in a misappropriation.

But defendant says (brief, pp. 15-16), "For aught the bank would know, though a check is payable to its depositor in a representative capacity, the money would belong absolutely to him," and then goes on to suggest that such checks might have been for Cahan, Jr.'s salary or family living expenses, or might have represented money already paid out by him in discharge of his fiduciary duties. But is the Bank entitled, under the decisions, to make this assumption? Manifestly, if as against the plaintiff the money belonged to Cahan, Jr., he was entitled to do with it as he pleased. He would have as much right to use it in payment

of an individual indebtedness to the Bank as for any other purpose. We submit that it is quite inconsistent to argue that the Bank is not entitled to assume that the money rightfully belongs to a fiduciary when it takes it in payment of an indebtedness owed to it, but is entitled so to assume when it deposits it to the fiduciary's individual account and so places him in a position to use it for the payment of his individual indebtedness to others.

(b) The rule is attended with a minimum of inconvenience.

The consideration of the questions involved in this action have in the past often been clouded by the insistence of banks that to apply to them rules which would ordinarily govern similar transactions between individuals is impracticable because of the volume of business which banks conduct and the speed with which their transactions are necessarily consummated. The impression has been sedulously cultivated that the rule of the instant case, when applied to banking institutions, must break down because of impracticability of enforcement.

It may well be queried to what extent the argument from inconvenience has a place in determining the decision of this case. Certainly this Court will not on such an argument disregard established legal principles. In *United States* v. *National Exchange Bank*, 270 U. S. 527, this Court said (pp. 534-535):

> "If this be true, then when the United States issues an order upon itself it has notice of the amount and when it comes to pay to an innocent holder making a claim as of right it is at arm's length and takes the risk. We are of opinion that the United States is not excepted from the general rule by the large-

> ness of its dealings and its having to employ agents to do what if done by a principal in person would leave no room for doubt."

Lord Justice Scrutton in *A. L. Underwood, Limited* v. *Bank of Liverpool*, [1924] 1 K. B., 775, 793, said:

> "If banks for fear of offending their customers will not make inquiries into unusual circumstances, they must take with the benefit of not annoying their customer the risk of liability because they do not inquire."

And in *Colonial Bank* v. *Cady and Williams*, L. R., 15 A. C. 267, 282, Lord Bramwell delivered the following pungent pronouncement:

> "One word on the alleged hardship on the defendants. I think there is none. I think they ought to have inquired as to these instruments. It is said business could not be transacted if that were necessary. The same thing was said when Lord Sheffield's case was decided. But, as has been shrewdly observed, such business is as lively as ever. I repeat my remark during the argument. Shopkeepers have said, when suing a husband, that they could not possibly ask the wife if she had his authority to pledge his credit—she would be offended. An excellent reason for not asking her, but not for making him pay."

We shall assume, however, that in the face of a conflict of authority, considerations of practicability and convenience may be given some weight.

Is there then anything in this spectre of impracticability which defendant's brief seeks to raise? We submit that, apart from the exigencies of those particular banks which,

like defendant, have become involved in liability through failure to observe it, the principle for which we contend is the most practicable and the least inconvenient which it is possible to devise in the present state of the authorities.

The rules which govern the liability of banking institutions should, above all, be simple and intelligible to paying tellers and receiving tellers and second assistant trust officers who are the persons by whose acts, omissions or knowledge the liability of the bank is usually determined. A consistent rule, which is definite and understandable, is infinitely preferable to an apparently more lenient one, which involves so many complications, exceptions and distinctions as to be quite unintelligible to an employee with no legal knowledge.

In this view we see no inconvenience in a rule which would require banks to give general instructions to their tellers not to permit, without special authority based upon adequate inquiry, the deposit to individual credit of a check drawn or endorsed by a fiduciary in his fiduciary capacity. Nor, the rule being once established, do we perceive any possibility of embarrassment as between banks and their customers. Banks are now obliged to explain to their depositors that under the law they cannot take fiduciary funds in payment of an individual indebtedness of the fiduciary. We can see no greater embarrassment in a tactful explanation that under the law the bank cannot, without adequate evidence of its propriety, take fiduciary funds for deposit in the fiduciary's individual checking account.

Such a rule is far less burdensome than the consequences of the decisions upon which defendant relies. Banks by no means escape inconvenience by establishing a

doctrine that they are entitled to receive deposits of fiduciary funds in the fiduciary's individual account. The principle that the form of the check charges the bank with notice that the funds are fiduciary funds is too deeply rooted now to be questioned. And that universally accepted principle makes the acceptance by the Bank of such a deposit a source of danger for an indefinite time to come. The resulting inconvenience is demonstrated by some of the cases upon which defendant most strongly relies.

In *Bischoff* v. *Yorkville Bank*, 218 N. Y. 106, one Poggenburg, who was an executor of an estate, kept an estate account in the Bowery Bank. He maintained an individual account in the defendant Yorkville Bank. He deposited in this individual account various checks drawn by himself upon the estate account. The Court of Appeals said (p. 110) that although the method adopted by Poggenburg was "unwise and hazardous", the deposit in itself "did not overpass the legal right of the executor or the defendant".

But here the troubles of the bank began. Poggenburg drew checks on this individual account to such an amount that nothing was left in the account, as the Court held, except estate funds. He then drew a check on this individual account to the order of the defendant bank in payment of a loan which he had individually contracted with it. Then, after making this and other payments upon his individual indebtedness to the bank, he drew other checks to third persons for other personal purposes of his in which, however, the defendant bank was in no wise interested. The Special Term and the Appellate Division granted the plaintiff, who was the substituted executor, recovery for all of the funds withdrawn from the Bowery Bank and deposited in the defendant bank except a small sum which had

not been misappropriated. The dissenting justice in the Appellate Division declared that the recovery should have been only for such sums as Poggenburg paid the defendant bank in liquidation of his individual indebtedness. The Court of Appeals differed from both of the above views. It held that the defendant originally had "the right to presume that the fiduciary will apply the funds to their proper purposes under the trust". But the Court of Appeals also held that the defendant bank "knew at all times that the credits created by the deposits of those moneys, through the checks of the executor, were equitably assets of the estate" and that "trust funds do not lose their character as such by being deposited in a bank for the individual credit and account of the person who is trustee"; that with this knowledge the bank "had not the right to participate in a diversion of them from the estate" and that it did participate in such a diversion either by "(a) acquiring an advantage or benefit directly through or from the diversion, or (b) joining in a diversion, in which it was not interested, with actual notice or knowledge that the diversion was intended or was being executed, and thereby becoming privy to it" (pp. 111-112). The Court of Appeals therefore held that the moment Poggenburg drew a check on his individual account to the defendant in payment of his individual indebtedness to it, the defendant could no longer "presume" that he was using that account for estate purposes and that the defendant was accordingly liable not only for the checks which it received in satisfaction of the indebtedness, but for every check drawn by Poggenburg after the first check so received by the defendant (pp. 113-114).

The inconvenience of this rule is obvious. Poggenburg's account with the defendant was an individual account.

Once give the bank the right to accept fiduciary funds in such an account, as a practical matter it is bound to accept them. It cannot decline without serious affront to its depositors. But the account being in the bank as an individual account, how is the bank to know, when the individual funds in the individual account have been expended and nothing but fiduciary funds remain? How impracticable to expect a junior employee, who is offered a check on an individual account of a depositor in payment of his individual indebtedness to the bank, to investigate whether that account, in spite of its apparent character, may not actually contain fiduciary funds which the bank has no right to take. What a serious inconvenience it is, when a check is drawn by the depositor on that account to a third person with whom the bank has no connection, to inquire before honoring it whether the bank may not have prior thereto received fiduciary funds in payment of the depositor's loan or overdraft.

In comparison with the inconvenience of the rule of the *Bischoff* case, the one for which we contend is simplicity itself. That rule would stop the evil at its source. The defendant bank would never have received fiduciary funds in the individual account and would never have been confronted with the problems which arose after their receipt.

Other cases in which a bank has been held liable where it has permitted a fiduciary to deposit checks showing on their face that they are drawn on fiduciary funds to the credit of his individual account and later has received checks from that individual account in payment of the fiduciary's indebtedness to it are *Hale* v. *Windsor Savings Bank*, 90 Vt. 487; *Brown* v. *Kyle*, 166 Wis. 347; *American Bonding Co.* v. *Fourth National Bank*, 205 Ala. 652, 206 Ala. 639,

640. The theory of all these cases is that where a fiduciary mingles fiduciary funds with his own and then draws checks on the mingled fund for his personal uses, it is presumed that his personal funds are first withdrawn (see *National Bank* v. *Insurance Co.*, 104 U. S. 54, 68), so that, when the account has been diminished to an amount not greater than the amount of fiduciary funds deposited therein, the subsequent withdrawals are from the fiduciary funds. Where the check deposited in the individual account shows on its face that it represents fiduciary funds, the bank is on notice, through the sight of the check by its receiving teller, of the fact that fiduciary funds have gone into the individual account; accordingly when the account has been diminished to the amount of the fiduciary funds and then a check is drawn by the fiduciary to pay his individual indebtedness,—albeit weeks or even months thereafter,—the bank is on notice through its bookkeepers and paying tellers that fiduciary funds are being used to pay the fiduciary's individual obligations. This rule is established by the overwhelming weight of authority.

Referring to the fear expressed by Judge Hough in the Court below that the rule adopted would be a hard one "not only in the financial institutions of the populous and busy city, but perhaps even more so in smaller communities, where men are more widely known by reputation and are more influenced by personal reputations than can be expected in the crowds of a cosmopolis" (R., p. 282), we submit that the desirability of the simple rule for which we contend is often more apparent in smaller communities than in metropolitan centers. It is in the smaller towns, where the personal and business affairs of everyone are well known to his neighbors, that the unquestionable rule

of the imputation of notice to a bank through the knowledge of its employees most seriously increases the hazards of accepting fiduciary funds for individual credit. Checks to the order of "Smith & Jones" or "Brown & Co.," which in New York City would have no suspicious significance, would be known by bank employees in a smaller community to be for the depositor's personal uses.

But in any community, large or small, it is manifestly impracticable for the bank to keep its tellers so advised of the state of an individual account in which trust funds have been mingled as to guard against liability for permitting their diversion. Unless, in addition to being permitted to accept the funds for individual credit, banks were also permitted to honor without liability any withdrawal thereof for any purpose,—which is manifestly impossible under the authorities,—the most convenient and workable practice is to refuse such deposits altogether unless satisfied of their propriety by adequate inquiry.

SECOND: The above rule applies a fortiori to agents who have no legal title to funds and upon whose authority the law imposes limitations, against use thereof for their own purposes, which all persons dealing with them are bound to notice.

It may be said that the deposit by an agent in his individual account of checks drawn by him in his principal's name to his own order or to the order of his depositary bank, is no more suspicious than such a deposit by any other fiduciary. It is true, however, that in the case of trustees, executors, guardians and other fiduciaries who have legal title to the funds under their control, it is pos-

sible to state reasons in attempted justification of such a deposit which do not apply to agents, who have no such title and who act by procuration only.

> "The title to the funds was in the executor, and he possessed the full control and disposition of them." (*Bischoff* v. *Yorkville Bank*, 218 N. Y. 106, 110.)
>
> "The executor was the owner. Whether he deposited in his own name or with the addition of the name of the estate, the title was unchanged." (*Whiting* v. *Hudson Trust*, 234 N. Y. 394, 406.)
>
> "The difference between the agent and trustee is that one holds the legal title and the other does not; one has full power to deal with the property, the other has only a limited power, depending upon the terms of the agency." (*Zane, Banks and Banking*, p. 217.)

It is such considerations as these that have led some courts in the case of a fiduciary who has legal title to the fund in question to say that it makes no legal difference, so far as the depositary bank is concerned, whether that fund is deposited in his name with the designation "Trustee" or "Executor" or in his individual name.

The distinction between such fiduciaries and agents is not only a legal one, but a practical one. The estate can act only through its executor or trustee. Therefore, in the case of an executor or trustee or other fiduciary who has the legal title, it may be argued that, practically as well as legally, the control of the fund remains the same when it is deposited in the individual name of the executor or trustee. But a principal may act himself or through other agents, and, therefore, if one agent deposits the principal's fund to his individual credit, the control of

the fund is vitally changed. Then only that agent can act with respect to it. It is taken out of the control of the principal.

Defendant says (Brief, p. 8) "The deposit with the defendant bank did not operate to take the funds out of his son's control". But it did take them out of plaintiff's control. While the funds were on deposit with the Guaranty Trust Company and the Agents of the Bank of Montreal, the plaintiff could himself draw checks upon them. He could also by mere revocation of the powers of attorney deprive Cahan, Jr., of all power over them. But once they were transferred to Cahan, Jr.'s individual account, plaintiff's control ceased. The defendant bound itself by its contract of deposit to honor any check that Cahan, Jr. might draw, and none which anyone else, even his principal, the plaintiff, might draw.

(a) Cahan, Jr., did not have actual authority either to draw checks for his own benefit or to dispose for his own benefit of the checks when drawn. He had no apparent authority to do these things as to any third person who was put on notice that he was acting for his own benefit.

Into every power of attorney or authorization to an agent to act "for", "on behalf of", or "in the name, place and stead of" a principal, the law reads the limitation that the power of attorney or authorization is not to be construed as including authority to use it for the agent's own benefit unless there be express language to that effect. In *Bank of New York* v. *American Dock and Trust Company*, 143 N. Y. 559, 564, the Court of Appeals, Judge Peckham writing, thus laid down this fundamental rule of agency:

> "It is an acknowledged principle of the law of agency that a general power or authority given to

the agent to do an act in behalf of the principal, does not extend to a case where it appears that the agent himself is the person interested on the other side.

"If such a power is intended to be given it must be expressed in language so plain that no other interpretation can rationally be given it, for it is against the general law of reason that an agent should be intrusted with power to act for his principal and for himself at the same time."

The same rule was stated by Judge Sanborn, writing for the Circuit Court of Appeals for the Eighth Circuit, in *Park Hotel Co.* v. *Fourth Nat. Bank of St. Louis*, 86 Fed. 742, 744, as follows:

"And while a promissory note, made by an agent or officer having such authority, in the usual form, and taken by a stranger in the ordinary course of business, carries with it the presumption that it was issued for corporate purposes, and under lawful authority, a note issued by such an agent, payable to himself, is accompanied by no such presumption, but is itself notice that it is without the scope of his general power, and that it does not bind his principal, unless its execution was specially authorized by the corporation, through its directors or officers, other than the agent to whom it is payable. Such a note is a danger signal, which the discounter or purchaser disregards at his peril. It is notice to him that, if it is contested, he cannot recover upon it, under any general authority in the agent, or at all, unless he proves that the agent was specially authorized to make that particular transaction, or to make contracts of the corporation with himself."

Judge Wallace in *Anderson* v. *Kissam*, 35 Fed. 699 (C. C. S. D. N. Y.), said, p. 703:

> "Therefore, if there is any significance in the fact that a bank president or cashier offers negotiable paper of his corporation, made by him in his official character, in payment of his personal debt, or to raise money for his personal use, it matters not that bankers generally do not appreciate it. • • • When he comes with money obligation of a corporation, which is the contract of a corporation only because he has made it, and which is not its contract if he has made it without authority, the transaction is a very different one."

It is not necessary to take issue with the rule laid down in *North River Bank* v. *Aymar*, 3 Hill, 262, or in the other cases cited by defendant, which follow it. *North River Bank* v. *Aymar* did not hold that the agent there involved had actual authority to make the notes in question, but simply that third persons who had no notice that he was acting outside of his authority and who took the notes for value could enforce them. The case must be read in connection with that of *Stainer* v. *Tysen*, 3 Hill, 279, decided at the same term. The net result of the two cases is that in neither did the agent have actual authority to issue or dispose of the notes in question; that the plaintiffs in *North River Bank* v. *Aymar* being unaffected by notice were protected by his apparent authority; but that the plaintiff in *Stainer* v. *Tysen*, who did have notice that the agent was transcending his actual authority, could not rely upon apparent authority. In *North River Bank* v. *Aymar*, Judge Cowen said (p. 266):

> "There is nothing in the nature or effect of such a power which authorizes the attorney to use it for

his own benefit or the benefit of any one excepting the principal. And if this limitation be such that an appointee would be bound to notice the fact that the attorney overstepped it, then these plaintiffs were properly cut off by the court below from their claim upon the contested notes and endorsements."

And in *Stainer* v. *Tysen* the same Judge said (pp. 280, 282):

"The argument by which those who advance money or discharge debts on the faith of paper executed under letters of attorney like this, claim that the principal should be bound at all events, is, that he has authorized another in general words and without any qualification to give his notes. * * * Some of us felt so much difficulty upon this argument in *The North River Bank* v. *Aymar*, that we held the question under advisement, and directed a second discussion, which took place in the course of the same term at which the present case was argued. (May term, 1842.) The answer given to the argument is, that such letters of attorney import, in their own nature, an obligation to act for and in behalf of the principal and in his proper business; * * *

"There is no doubt that a power drawn up nakedly to do acts for and in the name of the principal, negatives all idea of interest in the agent, or authority to act for the benefit of any one beside the principal. This limitation, therefore, the plaintiff was bound to notice."

And in *Bank of New York* v. *American Dock and Trust Company*, from which we have quoted (*supra*), the Court of Appeals held that where a corporation by-law gave its President general authority to issue warehouse receipts and the President purported to issue such a receipt as collateral

security for an individual debt, the creditor was not entitled to regard that act as within the President's authority. Judge Peckham said (143 N. Y., p. 565):

> "There was no actual or apparent authority conferred upon Stone to receipt for the defendant in any case in which it appeared that he was the person who deposited the cotton;"

A more recent application of this principle is *Porges* v. *United States Mortgage & Trust Co.*, 203 N. Y. 181, 190, where the Court said:

> "Conceding to Hoyt the power, under the instrument, to indorse the check in the name and behalf of plaintiff, his indorsement thereof for his personal use and gain was not within that power. If the power of attorney, invoked by defendant, did establish the power and right of Hoyt to effect plaintiff's indorsement of the check, it established at the same time that the depositing of it in and the receipt of it by the defendant for the credit and account of Hoyt exceeded his agency and authority. A power to act for another, however general its terms, or wide its scope, presupposes integrity and faithfulness in its exercise and cannot be enlarged by implication or construction to the justification of a diversion to the use of the agent of moneys or property subject to the agency. Manifestly this instrument did not transfer to Hoyt the ownership of the property to which it related. By virtue of it Hoyt was the plaintiff's attorney or agent with the powers it contained and for the purposes it prescribed. The law will not permit an attorney or agent under color of the authority bestowed by his principal to apply the property of that principal to his own use. That is a breach of trust which a court will not sanction or tolerate."

The decision of this Court cited by defendant under this head (*National Safe Deposit Co.* v. *Hibbs*, 229 U. S. 391) is wide of the mark. That involved stock certificates standing in the name of a third person and by him endorsed in blank; neither the face of the certificates nor any extrinsic circumstance gave the slightest notice of an agency or other fiduciary relation.

Authorities upon this general principle might readily be multiplied. They are summed up in the following passage from 2 *Corpus Juris*, 642-643:

> "The broadest possible authority to make and indorse paper presumptively is to be exercised in the principal's interest only, and does not impliedly extend to making or indorsing paper for the accommodation of third persons, and still less for the agent himself. Accordingly, in the absence of a very clear showing of such authority, an agent has no power under the broadest terms in the letter of appointment to make or indorse negotiable paper for his own interest, in the name of his principal, or for his own interest and that of the principal. • • • The principal will not, however, be bound if the third person knew, or if the transaction showed upon its face, that the agent made the paper for his own use or for the accommodation of a third person, for these are acts that are not authorized, and on their face carry to the third person knowledge of that fact; and if the paper is made payable to the agent himself it should put third persons on guard as to the agent's authority and the purposes for which he is using his principal's credit."

Applying the above principles to the instant case, these twenty-one checks were utterly unsupported by any actual authority. As they were drawn for no purpose of plain-

tiff but for Cahan, Jr.'s individual benefit, there was no actual authority even for drawing them. And apparent authority disappears the moment the third person has notice that the actual authority is being transcended. The question, therefore, is always one of notice, and Cahan Jr.'s tender of these checks, drawn by himself as attorney in fact, to his own order, for deposit in his individual bank account, was sufficient notice that he was using his principal's funds for his individual purposes and hence was transcending the actual limits of the authority entrusted to him by the plaintiff.

(b) The weight of authority, with respect to agents, is that they are not entitled to deposit their principals' funds to individual credit, and that a bank which permits such a deposit is liable for a resulting misappropriation.

Most of the cases cited by defendant in the list appearing on pages 8 and 9 of its brief are cases of fiduciaries who had the legal title. Defendant does not contend otherwise. The only cases which defendant cites as holding that an agent or corporate officer may deposit the funds of his principal in an individual bank account are collected at page 14 of its brief.

On examination, however, it will be found that few even of these cases sustain the proposition. The New York authorities will be separately considered in the next subdivision. Of the other citations, *Safe Deposit & Trust Co. v. Bank*, 194 Pa. St. 334, involved an administrator, who of course had legal title. *Goodwin v. American National Bank*, 48 Conn. 550 is likewise miscited. While the fiduciary involved in that case was both an executor and a town treasurer, only his defalcations as executor were involved; his

defalcations as town treasurer were described only to show the manner in which the estate funds had been misappropriated.

Charleston Paint Co. v. *Exchange Banking & Trust Co.*, 129 S. C. 290, did not involve an individual deposit. The criticism there was that the attorney had placed the check in an account entitled "R, Attorney" instead of "R, Attorney for Charleston Paint Company". The discussion of the right of the agent with respect to deposit was all dictum. The holding was that if the check was materially altered it amounted to a forgery and the bank was not a holder in due course, and a judgment in the bank's favor was reversed for erroneous instructions to the jury with respect to that issue.

The Missouri cases cited are far from holding the broad principle asserted by defendant. In *McCullam* v. *Third National Bank*, 209 Mo. App. 266, the Court said (pp. 279-280, 281):

> "Indeed, circumstances may attend the shifting of corporate funds to the officer's personal account which would afford adequate notice to the bank to reasonably support the inference that misappropriation was intended. • • • The facts in a given case, of course, and, indeed, only slightly different from the facts here, may be such as to place the bank on guard."

The Court, however, held that the circumstances in that case were such as to negative notice. There was evidence that a large part of the corporation's business was transacted through the officer's personal account, because of the fact that the corporation was failing and was heavily indebted to its own banks. It was shown that another officer

of the corporation knew of and acquiesced in these transfers, and indeed there was no proof that the officer in question had in fact misappropriated anything. The other Missouri case cited, *Gate City Building & Loan Association* v. *National Bank*, 126 Mo. 82, involved a similar state of facts. The "general fiscal agent" of the plaintiff association had a personal account and an association account with the same bank, the defendant. He had for a long time endorsed checks which had been made to the order of the association, sometimes into the one and sometimes into the other account, without objection by the other officers, and had customarily adjusted the two accounts by drawing checks on his personal account to the credit of the association account.

The English case of *Corporation Agencies, Ltd.* v. *Home Bank of Canada*, which the defendant prints in an appendix to its brief, has several distinguishing features. In the first place the checks, under a by-law of the plaintiff corporation, were signed by another officer of the corporation in addition to the one to whose individual order they were made payable. The case was not, therefore, one in which, as Judge Wallace said in *Anderson* v. *Kissam*, 35 Fed. 699, 703, the officer "comes with money obligation of a corporation, which is the contract of a corporation only because he has made it."

A further distinction is found in the ground of decision stated by the Privy Council in the portion of its opinion which appears at pages 36-37 of defendant's brief:

> "Moreover, the fact was that the plaintiff's moneys were not being appropriated and applied by Cahan, Junior, at all. His father's moneys and the moneys of the various companies on whose accounts

> he was entitled to draw and did draw were no doubt being misappropriated, but so far as the plaintiffs were concerned Cahan, Junior, was doing no more than paying into their account moneys which did not belong to them and drawing out to the like amount moneys with which the Company, in fact, had no concern. Neither the payments into nor the drawings out of the Company's account were authorized acts. The Company cannot repudiate the one and take the benefit of the other."

The above analysis leaves only the *Santa Marina* case in the Federal Court, and the authorities cited from New York (which will be hereafter discussed), Massachusetts and Washington as authorities for the rule asserted by defendant, against which may be cited all of the cases which appear at pages 7 to 8 under Point First of this brief. Most of these cases involved agents, and the few of them which involved fiduciaries who had legal title are of course *a fortiori* authority for our contention.

Judge Story in his book on Agency says, Section 208:

> "Thus, in regard to agents receiving money for their principals, it seems (as has been already suggested), a clear duty, if they deposit the money in the hands of bankers, to deposit it in the name of their principals, and not in their own names; and if they adopt the latter course, and the bankers should become insolvent, the agents would become personally responsible for the loss."

That such a deposit amounts to a conversion both by the agent and his depositary bank has been frequently held.

Wagner Trading Co. v. *Battery Park National Bank*, 228 N. Y. 37, was an action at law for conversion, in which it appeared that Wagner, the President of the plaintiff corporation, who had general authority to endorse paper, endorsed cashier's checks, drawn to the order of the plaintiff, "Wagner Trading Company, C. J. Wagner, Pres.", and deposited them in his personal account with the defendant bank which paid out the proceeds thereof on his personal checks. There was no use of the funds to pay any personal indebtedness of Wagner to the bank. The Court of Appeals held the bank liable for the resulting misappropriation, saying (pp. 41-42):

> "The facts showing the conversion are complete. Wagner had authority to indorse the checks, although no by-law or resolution is in evidence to that effect, but only for the purposes of the corporation's business and not to transfer the checks to himself personally or for his personal use. The defendant endeavored to prove estoppel and negligence of the plaintiff. The trial court rightly excluded all such evidence. The plaintiff had no relations with and owed no special duty to the defendant. It was not a depositor of the defendant. * * * When it accepted the checks payable to the plaintiff and indorsed by Wagner as president of the plaintiff for deposit to the account of Wagner himself, it did so at its peril to ascertain whether Wagner had authority to indorse them and by his indorsement transfer the money to be paid thereon to his personal account. (*Cheever* v. *Pittsburgh, S. & L. E. R. R. Co.*, 150 N. Y. 59; *Ward* v. *City Trust Co. of N. Y.*, 192 N. Y. 61, 71.) If Wagner had no such authority, title to the money in question never passed to the defendant and if it received it, it did so without authority and must account and make payment to the owner. (*Schmidt*

v. *Garfield National Bank*, 64 Hun, 298; affirmed, 138 N. Y. 631; *Sims* v. *U. S. Trust Co. of N. Y.*, 103 N. Y. 472; *Fidelity & Deposit Co. of Maryland* v. *Queens County Trust Company*, 226 N. Y. 225, 233.)"

And in *Porges* v. *United States Mortgage and Trust Company*, 203 N. Y. 181, *supra*, in which one Hoyt, the agent under power of attorney of an individual principal, did the same thing, the court held that the agent was guilty of a conversion of the check and that it was equally clear "that defendant [his depositary bank] did, by receiving the check for the credit of Hoyt and collecting and receiving its proceeds, convert the check, unless the acts of Hoyt in relation to it were within his agency."

See also *E. Moch Co.* v. *Security Bank*, 176 App. Div. 842, 846 (affirmed without opinion in 225 N. Y. 723); *A. L. Underwood, Ltd.* v. *Bank of Liverpool*, [1924] 1 K. B. 775, 790, 795-796.

(c) The New York decisions.

It is not too much to say that the decisions of the New York State courts upon this question are now in a condition of utter confusion.

Until the case of *Havana Central Railroad Co.* v. *Knickerbocker Trust Co.*, 198 N. Y. 422, the New York authorities had been entirely consistent. In *Sims* v. *United States Trust Company*, 103 N. Y. 472, which was an action at law, it appeared that the plaintiff, who had an account with the Peoples' Bank, drew thereon a check to the order of the defendant trust company and gave it to his agent with verbal instructions to deposit it to plaintiff's credit with the defendant. Instead of doing so, the agent delivered the check to defendant and took from it a certificate of

deposit payable to himself as trustee for the plaintiff and thereafter drew out the money and converted it to his own use. The Court of Appeals held the defendant Trust Company liable, saying (pp. 475-476):

> "The check upon its face imported the ownership of the moneys represented in it by Dr. Sims, and his desire that its custody should be transferred from the People's Bank to the defendant. This certainly did not warrant the defendant in supposing that Dr. Sims thereby intended to pay $5,000 to Crowell, or place him for any purpose in possession of the fund. If he had so intended, the check would have been made payable to Crowell's order, and there would have been no need of the agency of the defendant in the transaction. The use of the defendant's name as payee of the check indicated the drawer's intention to lodge the moneys in its custody and place them under its control, and nothing further than this was inferable from the language of the check."

This language is directly applicable to the three checks, aggregating $7,500, which Cahan, Jr., drew as attorney in fact to the order of the defendant. Their signature "C. H. Cahan, by C. H. Cahan, Jr., his attorney" "imported the ownership of the moneys" represented thereby in the plaintiff. There was nothing in Cahan, Jr.'s possession of those checks which gave the defendant any right to suppose that the plaintiff intended them to be credited to Cahan, Jr.'s, individual account. If Cahan, Jr., had any authority to draw the checks, the natural presumption would be that the plaintiff intended him to draw them for the purpose of opening an account in his (plaintiff's) name, with the Empire Trust Co.

Following the *Sims* case, came an important line of Court of Appeals decisions holding the bank liable where it took checks in payment of the agent's individual indebtedness to it (*Gerard* v. *McCormick*, 130 N. Y. 261; *Rochester & Charlotte Turnpike Road Co.* v. *Paviour*, 164 N. Y. 281; *Ward* v. *City Trust Co.*, 192 N. Y. 61) as well as the case of *Spaulding* v. *Kelly*, 43 Hun, 301 where the indebtedness feature did not appear.

Then came the *Havana Central* case in which, as we have shown above, the Special Term and the Appellate Division held that the fact that the funds after having been deposited in the agent's individual account were checked out in payment of his personal obligations to third persons rather than to the bank itself made no difference with respect to the bank's liability for the misappropriation which had been directly made possible by the individual deposit. The decision of the Court of Appeals in the *Havana Central* case was that the depositary bank's conceded duty of inquiry was satisfied by the honoring of the checks by the *drawee* bank, which amounted to a "representation" by it as the "agent" of the principal that the checks were "all right." This decision was a "sport", which seriously confused the New York law.

The Appellate Division in the later case of *Niagara Woolen Co.* v. *Pacific Bank*, 141 App. Div. 265, held the bank liable in a case in which the fiduciary account and the individual account were in the same bank, so that there was no separate drawee bank to make representations as the agent of the depositor. That case was never appealed to the Court of Appeals. There followed *Porges* v. *U. S. Mortgage & Trust Co.*, 203 N. Y. 181, where again it was impossible to rest upon the "agency" of the drawee bank because

the check which was deposited in the individual account of the agent was one drawn to the order of the principal, endorsed by the agent in the principal's name and again by the agent individually and deposited in his personal account. The bank was again held liable.

Then came *Bischoff* v. *Yorkville Bank*, 218 N. Y. 106, already abstracted, which involved an executor who had legal title. The Court of Appeals said that the bank might legally take a deposit of the trust fund to the fiduciary's individual account and credit, but, as we have shown, held the bank to a logical, albeit strict, standard of care with respect to the manner in which it might permit the executor to deal with the fund once it was so deposited. The next case was *Fidelity & Deposit Co.* v. *Queens County Trust Co.*, 226 N. Y. 225, which involved a trustee in bankruptcy who also had legal title to the funds. Then came *Wagner Trading Co.* v. *Battery Park National Bank*, 228 N. Y. 37, which held that the bank had been guilty of conversion when it permitted a corporate officer to deposit in his individual account the check of a third person drawn to the order of the corporation, and endorsed in the corporation's name by himself as agent. Here again the facts did not permit recourse either to the legal title theory or to the "rule" of the *Havana Central* case regarding the agency of the drawee bank.

The only other case of importance in the Court of Appeals is *Whiting* v. *Hudson Trust Company*, 234 N. Y. 394, where an effort to clarify the confusion of the prior cases only led to further obscurity. That case involved misappropriations of checks drawn by one E. in two different forms. The first was drawn by E. as "attorney in fact" to his own order as "trustee" and deposited with

the defendant trust company as the opening deposit in a new account designated "special". The first distinction to be noted is that such a deposit in a new "special" account is quite different from a deposit in a current individual account. Apart from this distinction the facts as to this transaction were substantially the same as those involved in the *Havana Central* case. The Court of Appeals knocked every prop from under the *Havana Central* decision by recognizing the error of its fundamental conception that the drawee bank was the plaintiff's agent. But it avoided a flat disagreement with the result of that case, by attributing to the fact of certification the consequence that the taker of the check was relieved from notice or obligation of inquiry. The Court attempted to distinguish cases such as the *Porges* and *Wagner Trading Company* cases on the ground that they involved endorsements rather than the drawing of checks. The attempted distinction is unsubstantial. Bearing in mind that the question is entirely that of the extent of notice received by the depositary bank, it can make no possible difference whether the agent draws a check in the name of the principal to his own order and endorses that to the order of his depositary bank, or endorses in the name of his principal to his own order, and then endorses individually, the check of a third person originally drawn to his principal. It is then useless to argue, as defendant does (brief, p. 20), that the *Whiting* case does not go off on the fact that the check was certified. Having disagreed with the basis of the *Havana Central* decision, the Court of Appeals could not, consistently with its other decisions to which reference has already been made, have reached the result in the *Whiting* case upon any other ground.

The second class of checks involved in the *Whiting* case were drawn by third persons to the order of E. as executor of an estate and by him deposited in his "special" account above mentioned. With respect to these transactions, which involved endorsements rather than the drawing of checks, the Court's distinction of the *Wagner Trading Company* case fails, and the decision in favor of the bank must therefore rest on the ground stated by the Court that "the executor was owner" and that "the title was unchanged."

We have discussed the New York State authorities at some length because of the reluctance expressed by the Circuit Court of Appeals in this case to differ from the State Court of Appeals. We submit that when the authorities in a state court are in as chaotic a condition as the New York decisions on this question, such reluctance on the part of a national court is unnecessary.

THIRD: The facts of the present case require affirmance of the judgment whether or not the broad rule announced by the Court below is adopted.

This is not a case in which the defendant had no notice except such as was presented to its receiving teller through the form and contents of the checks themselves.

The transcript of Cahan, Jr.'s account with the defendant (Plaintiff's Exhibit 11, R., pp. 197-214) shows that it was opened on September 29, 1915, and that it had been operated with great activity for nine months and more before the first of the plaintiff's checks was deposited therein on July 12, 1916. The account was exactly the sort which would be normal to the personal checking account of a man of Cahan, Jr.'s age and position. It had no characteristic

which would give the defendant the slightest reason to suppose that it was an account operated by Cahan, Jr., for the plaintiff's benefit and purposes. Plaintiff never had any relations of any kind with defendant.

Moreover, this is not a case where it is necessary to piece together facts known by a number of subordinate employees in order to impute notice to the bank. The second check of the series was, with all its implications, brought pointedly to the attention of a responsible officer of the defendant.

Mr. Lyon, the Treasurer of the defendant, testified (R., fols. 422-431) that on August 2, 1916, (Def's. Exh. A-19, fol. 694) when Cahan, Jr's. balance was $49.98 (R. p. 204; see also fols. 307-308), he brought to the bank a check for $5,000 drawn in the plaintiff's name by himself as attorney in fact and to his own order and asked that it be credited to his personal account with defendant as a "cash item" so that he could draw on it immediately. A rule of the defendant prevented withdrawal the same day even if the deposited check was certified, unless the check was approved "for immediate credit" by an officer of the bank. If we accept Mr. Lyon's testimony, it was for that reason that this check was brought to him by the receiving teller. The transaction was thus presented as a whole to Mr. Lyon. And the transaction certainly provoked inquiry. What explanation consistent with faithfulness on the part of Cahan, Jr., was there for the necessity of these funds being taken "for immediate credit". Certainly not the necessity of paying the plaintiff's obligations. That could be done as well by the drawing of a check on the plaintiff's bank account upon which this very check tendered by Cahan, Jr.,

had been drawn. The necessity for immediate credit must have been Cahan, Jr.'s personally.

It is fairly inferable from Mr. Lyon's testimony that one reason why similar checks later presented by Cahan, Jr., were not also brought to the attention of responsible officers of the defendant was that the receiving teller, having seen the second check of the series approved without any inquiry, did not feel called upon to present the same question to him or any other officer of the defendant on subsequent occasions.

Moreover, there were three days, namely, September 1, 1916, April 12, 1917, and May 26, 1917, on each of which there was a withdrawal of such size that the balance to the credit of the account at the opening of business would not have been sufficient to satisfy the withdrawal without the deposit of one of these fraudulent checks. None of these three checks was approved "for immediate credit" under defendant's rule above referred to, and Cahan, Jr., was therefore not entitled to make withdrawals against them until the following day. It was these three occasions, and not, as defendant argues (Brief, p. 22), the three checks drawn to the order of defendant, to which the District Judge referred when he said (R., fol. 727):

> "Whether the checks were drawn to pay the agent's indebtedness to the defendant (which would seem to be the case in three instances referred to) • • •".

There was evidence to sustain that finding. The three instances referred to appear respectively in the account as follows: That of September 1, 1916, bottom of page 204; that of April 12, 1917, middle of page 209; and that of

May 26, 1917, at page 210. In the instance of September 1, 1916, the withdrawal and the credit appear upon the same line of the account, while in the instances of April 12 and May 26, 1917, the withdrawal appears on the line under that on which the deposit is entered. Mr. Banks, the auditor of the bank, testified (fols. 311-312, 314-315, 331-337) that the fact that the withdrawal appeared on the line under the deposit was some indication that the deposit preceded the withdrawal. But in view of his testimony as to the manner in which the defendant's books were kept, the inference to be drawn from the relative position of the entries of withdrawals and deposits was of slight, if any, probative value as to the actual chronology. He testified (fols. 350-360) that withdrawals were not entered at the time they were made, but checks were kept in a batch until a considerable number had accumulated; and that then the entries of the withdrawals occasioned thereby were made at the same time in alphabetical rather than chronological order. According to Mr. Banks' testimony, the fact that on September 1, 1916, the withdrawal and the deposit appeared on the same line would indicate that the transactions were contemporaneous or, as he expressly testified with respect to this transaction, that it was impossible to tell which had happened first (fols. 344-346).

In truth, each of these withdrawals created an indebtedness from Cahan, Jr., to the defendant which was not satisfied until the defendant received the funds on the deposited checks through the clearing house.

It is, of course, unquestioned law that an overdraft is no different from any other personal indebtedness and that a bank which receives fiduciary funds, with knowledge of their character, to cover an overdraft in the agent's per-

sonal account, is liable therefor to the principal. *Allen v. Puritan Trust Co.*, 211 Mass. 409; *Santa Marina Co. v. Canadian Bank*, 242 Fed. 142, 254 Fed. 391.

But even if the withdrawals on those days had not technically created "overdrafts" the result would not be changed. We have pointed out above that the reason for the rule which holds the bank liable for taking fiduciary funds in payment of the agent's individual indebtedness is not the benefit thereby received by the bank, but that such circumstance is notice to the bank that fiduciary funds are being used for the agent's personal benefit rather than for the purposes of the principal. On September 1, 1916, April 12, 1917, and May 26, 1917, the defendant had directly presented to it the question whether it would honor checks drawn by Cahan, Jr., on his individual account and it permitted such a withdrawal only because it received upon the same day,—and probably at the same moment,—checks of the plaintiff drawn by Cahan, Jr., to his own order in amounts sufficient when later paid to cover the withdrawals in question. We submit that no possible distinction can be made between such a case and that in which the deposit of fiduciary funds is made to cover an earlier overdraft in the agent's account.

The situation presented to Mr. Lyon on August 2, 1916, was essentially similar. Under the rule of *Bischoff v. Yorkville Bank*, 218 N. Y. 106, the defendant was on notice from and after August 2, 1916, that Cahan, Jr., was using his principal's funds for his individual benefit, and the rule of that case is sufficient to sustain the judgment herein as to the amount of all the checks, except the first one of July 1, 1916, for $1,000.

FOURTH: Certification or acceptance by drawee banks has no effect on defendant's duty of inquiry.

It is not necessary to devote extended discussion to defendant's argument on the effect of certification, which it bases upon *Whiting* v. *Hudson Trust Co., supra.* We might rest the discussion upon Judge Hough's answer to this question in the lower court (R. pp. 275, 283). The effect of certification as substantially equivalent to acceptance has from very early times been fairly well understood. *First National Bank of New Jersey* v. *Leach*, 52 N. Y. 350, 353; *First National Bank of Washington* v. *Whitman*, 94 U. S. 343, 345.

It is only necessary to add that the statement of the Court of Appeals in the *Whiting* case should not be regarded, as defendant puts it, as the "New York rule" relating to certification. *Whiting* v. *Hudson Trust Co.* was the result of the judicial exigency of correcting the erroneous ground assigned for the decision in the *Havana Central* case without flatly overruling it. It appears from the record that two of the checks involved in the *Havana Central* case had been certified so that in the *Whiting* case exactly the same state of facts was involved. The Court of Appeals seized upon the fact of certification to sustain a decision, the ground of which it felt obliged to disapprove.

The extract from the opinion in *Whiting* v. *Hudson Trust Company*, which defendant quotes (brief, p. 17) should not be regarded as laying down a rule that certification justifies a bank in receiving a check with its eyes shut. Suppose that Cahan, Jr., when presenting one of the certified checks here in suit for credit to his individual account,

had said to the receiving teller "You know I have no right to this money. It belongs to my father but I need it to cover margins on one of my stock speculations." Would the fact that "as between the drawee bank and its depositor the check had been paid", protect the defendant if it accepted such deposit and later honored a check by Cahan, Jr., to the order of his stock brokers? And if the above question requires a negative answer, is there any reason for a different rule of notice in the case of the tender of any certified check bearing on its face notice that it represents fiduciary funds, merely because the check has been accepted or certified?

FIFTH: The defendant was not a holder in due course under the Negotiable Instruments Law.

Defendant argues that it became a holder in due course of the checks in question. Plainly it must take this position to escape an otherwise clear liability for conversion. Cahan, Jr., legally had no right to enforce payment of these checks as against plaintiff. He had no title thereto. Cahan, Jr., could not, and did not, give to defendant a better title than he himself had, unless defendant became a holder in due course and so was protected under Section 96 of the New York Negotiable Instruments Law.

We do not propose to enter upon a discussion as to whether the defendant is to be regarded as an agent for collection or a purchaser of the checks. Assuming that it was a purchaser, it was not a holder in due course. Section 91 of the New York Negotiable Instruments Law defining a holder in due course is quoted on page 25 of defendant's brief. Neither the first, third, nor fourth, requirement is

satisfied in the present case. The checks were not "regular upon their face". *Gilman* v. *F. O. Bailey Carriage Co.*, 125 Me. 108. See quotation from *Ward* v. *City Trust Co.*, 192 N. Y. 61, 73, *supra*, p. 16. "There was a shadow on the checks, and the defendant could not, in good faith, accept them until it disappeared." *Rochester & Charlotte Turnpike Road Co.* v. *Paviour*, 164 N. Y. 281, 285-286.

Passing to the fourth requisite, the defendant had notice of defect in the title of the person negotiating the checks. Section 98 of the New York Negotiable Instruments Law provides that "when it is shown that the title of any person who has negotiated the instrument was defective, the burden is on the holder to prove that he or some person under whom he claims acquired the title as a holder in due course." The title of Cahan, Jr., who "negotiated the instrument", was certainly "defective" and plaintiff established the fact. New York Negotiable Instruments Law, Sec. 94. Therefore, under Section 98, the burden of proof shifted to defendant to establish that it was a holder in due course. Defendant refers (Brief, p. 26) to Section 95 of the Negotiable Instruments Law regarding notice. This, however, does no more than codify the common law rule which has applied in New York State as well as in the federal courts.

The cases cited by defendant under its Point II at pages 27 and 28 of its brief regarding notice are totally inapplicable. They have to do with notice of facts *dehors* the instrument. *Cheever* v. *Pittsburgh, etc. Co.*, 150 N. Y. 59, was expressly distinguished in *Ward* v. *City Trust Co.*, 192 N. Y. 61, 73, in the extract already quoted (*supra*, p. 16). Moreover, this Court has said in *Angle* v. *North-Western Mutual Life Insurance Co.*, 92 U. S. 330, 342:

> "Actual notice in such a case is not required, even in suits founded upon negotiable securities,

> where the evidence of its infirmity consists of matters apparent on its face; • • •
>
> "Constructive notice in such cases is held sufficient, upon the ground, that, when a party is about to perform an act which he has reason to believe may affect the rights of third persons, an inquiry as to the facts is a moral duty, and diligence an act of justice."

It is generally held that one who takes a negotiable instrument has notice within the meaning of Section 95 if he has knowledge of facts which put him on inquiry. *Hoberg* v. *Sofranscy*, 217 App. Div. 546. And numerous cases hold that the rule regarding the duty of inquiry of one who receives a negotiable instrument from a fiduciary is not changed or affected by this section of the Negotiable Instruments Law. See *Union Nat. Bank.* v. *Bluff City Bank*, 152 Tenn. 486, 491-3, with an extensive collection of authorities.

The courts of New York State have always enforced the rule that bad faith in the commercial sense includes a failure to inquire when the facts impose a duty of inquiry. In *Rochester & Charlotte Turnpike Road Co.* v. *Paviour*, 164 N. Y. 281, 284, the Court of Appeals said:

> "Even if his actual good faith is not questioned, if the facts known to him should have led him to inquire, and by inquiry he would have discovered the real situation, in a commercial sense he acted in bad faith and the law will withhold from him the protection that it would otherwise extend."

See also the language of the same Court in *Ward* v. *City Trust Co., supra*, and *Fidelity & Deposit Company* v. *Queens County Trust Co.*, 226 N. Y. 225, 233.

The same reason precludes a contention on defendant's part that it took these checks in good faith under the third requirement of Section 91.

Defendant's reference to the Negotiable Instruments Law therefore brings us back to exactly the same question which has been heretofore discussed: Were the facts of which the defendant had notice sufficient to impose upon it a duty to inquire whether Cahan, Jr., had authority from the plaintiff to draw these checks and deposit them in his individual bank account with the defendant? If so, defendant is no more a holder in due course under the Negotiable Instruments Law than it is protected from liability under the principles of the common law.

SIXTH: The judgment should be affirmed.

Respectfully submitted,

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OPINION

SUPREME COURT OF THE UNITED STATES.

No. 318.—October Term, 1926.

Empire Trust Company, Petitioner, vs. Charles Hazlitt Cahan.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[May 31, 1927.]

Mr. Justice Holmes delivered the opinion of the Court.

This is a suit brought by the respondents to charge the petitioner with liability for the proceeds of checks drawn upon the Agents of the Bank of Montreal or the Guaranty Trust Company, in New York and deposited with the petitioner by the respondent's son. The respondent, a Canadian lawyer, had accounts with the two banks named and in 1916 gave to his son powers of attorney to draw checks upon them, both powers being general and with no qualification as to the purposes for which such checks might be drawn. Beginning in July of that year and from time to time down to October, 1918, the son drew checks signed with his father's name by himself as attorney against his father's two accounts, payable seventeen to his own order, three to the order of the petitioner, and deposited them to his own private account with the petitioner. All the checks but two were certified by the Guaranty Trust Company or accepted by the other bank as the case might be. Subsequently the son drew out these funds and applied them to his own use. The respondent did not discover the fraud until the end of 1919, at which time his son absconded. The petitioner had no knowledge that the son was misappropriating his father's money and no notice other than what was given by the form of the checks. The District Court and the Circuit Court of Appeals for the Second Circuit held that notice sufficient to charge the petitioner as matter of law and gave judgment against it, the Circuit Court of Appeals adding interest on the several items from

the date when they were credited to the son. 9 F. (2d) 713. A writ of certiorari was granted by this Court. 271 U. S. 653.

No doubt the question is, as was said by the Circuit Court of Appeals, a question of degree, like most questions in the law; but we are of opinion that the Court below applied too strict a rule to an ordinary business transaction. The Court itself pronounced it 'a hard rule as business is ordinarily conducted,' and seemingly adopted it as much because of authority by which it felt bound as because it confidently thought the rule right. The petitioner had notice that the checks were drawn upon the respondent's account, but they were drawn in pursuance of an unlimited authority. We do not perceive on what ground the petitioner could be held bound to assume that checks thus lawfully drawn were required to be held or used for one purpose rather than another. In the case of checks drawn by a corporation not likely to disburse except for corporate purposes there might be stronger reasons for requiring a bank to be on its guard if an officer having power to draw them deposited checks for considerable sums to his private account; but it recently has been held otherwise by the Judicial Committee of the Privy Council. *The Corporation Agencies, Limited* v. *The Home Bank of Canada* [1927] A. C. 318. And when the two parties are father and son, both of mature years and in good standing, secret limitations of the power are a pure matter of speculation into which it seems to us extravagant to expect the bank to inquire. The person reposing confidence in the son was not the petitioner but the respondent, *National Safe Deposit, Savings & Trust Co.* v. *Hibbs*, 229 U. S. 391, 397, and he himself tells us that his confidence was unlimited. He put his deposits absolutely into his son's power, and the son, if he drew currency, as he might, could do with it as he saw fit. The notice to the bank was notice only of this relation of the parties. The petitioner in permitting the son to draw out the money was permitting only what it, like the respondent's banks, would have been bound to allow even if the deposit had been earmarked as a trust. The form in which the withdrawals took place does not appear. They might have been, like the deposits, in checks to the son's own order. All that is known is that the respondent did not get the benefit of them. But we do not place our decision upon that narrow ground. For in addition to what we have said, the transactions

went on for over two years and the petitioner fairly might expect the respondent to find it out in a month or two if anything was wrong. Careful people generally look over their bank accounts rather frequently.

It is very desirable that the decision of the Courts of the United States and that of the highest Court of the State where the business was done, should agree, as was recognized by the Circuit Court of Appeals. The result to which we come restores that agreement, at least when the checks are certified or accepted by the banks upon which they are drawn, as was the case here with all but two. *Whiting* v. *Hudson Trust Co.*, 234 N. Y. 394. The certification did not import a statement by the certifying bank that, beside the right of the son to draw, established by the power of attorney, the purposes for which the checks were drawn were lawful and were known by the bank. As the Court remarks in the case cited 'The transactions of banking in a great financial centre are not to be clogged, or their pace slackened, by over-burdens or restrictions.' 234 N. Y. 406.

Judgment reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.